IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

U.S. COMMODITY FUTURES TRADING COMMISSION, **Plaintiff,** **v.** **KRAFT FOODS GROUP, INC. and MONDELĒZ GLOBAL LLC,** **Defendants.**	)))))))))))))	**Civil Action No. 15-2881** **Hon. John Robert Blakey**

MEMORANDUM IN SUPPORT OF DEFENDANTS' MOTION TO DISMISS COUNTS I AND II OF THE COMPLAINT

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Defendants Kraft Foods Group, Inc. and Mondelēz Global LLC (for purposes of this motion, referred to collectively as Kraft (*see* Compl. ¶ 10) or the Company) move pursuant to Federal Rule of Civil Procedure 12(b)(6) to dismiss Counts I and II of Plaintiff U.S. Commodity Futures Trading Commission's (CFTC) Complaint.

INTRODUCTION

This case is about a snack-food company that made reasonable business decisions to maintain a steady wheat supply in the face of an uncertain market. For years, the price of wheat on the cash market has borne little relation to the price of wheat on the futures market. The CFTC has assured the public that correcting this imbalance is at "the core of [its] mission," and that an accurate pricing mechanism benefits "producers . . . millers, purchasers, bakeries" and, ultimately, "the American public."[1] The CFTC's assurances to the contrary, Kraft operates in the wheat market as it actually exists—not the wheat market as the CFTC has idealized it. For years, that market has been dysfunctional.

At its core, the CFTC's Complaint accuses Kraft of fraud and manipulation for seeking to purchase wheat at the best price it could in the face of difficult market conditions. In late 2011, facing a dwindling wheat supply and high prices in the cash market, Kraft made the rational decision to obtain the wheat it needed for its flour mills (for ultimate use in the production of cookies, crackers, and other snack foods) by purchasing and taking delivery of less-expensive wheat futures. The Company's decision had several consequences. First, it began receiving wheat located in unfavorable locations. Second, prices in the cash wheat market began to fall after Kraft—which the CFTC acknowledges is one of the country's largest purchasers of the variety of wheat at issue in this case—went elsewhere for its needs. As cash wheat prices began

[1] *Excessive Speculation in the Wheat Market: Hearing Before the S. Perm. Subcomm. on Investigations*, S. Hrg. 111-155 at 19 (July 21, 2009) (testimony of Gary Gensler, Chairman, CFTC).

to come down, Kraft then made a second business decision: it resold its remaining shipping certificates, closed its open December futures position (two of several available options) and began purchasing cash wheat at lower prices.

These decisions and consequences do not transform Kraft's conduct into a fraud or a manipulation. They are, instead, an example of a consumer of wheat "seeking the best price for [its] commodity," an activity the CFTC recognizes as a "legitimate, indeed critical price-creating force in the futures market." *In re Indiana Farm Bureau Coop. Ass'n*, CFTC No. 75-14, 1982 WL 30249, at *9 (Dec. 17, 1982). Nonetheless, the CFTC has charged Kraft with fraud and manipulation in the Commission's first case testing the limits of its new fraud-based anti-manipulation authority.

But the CFTC's assertion of that new authority, contained in Count I, is unsupported by the facts alleged in the Complaint. When the Court looks past the Complaint's numerous conclusory allegations (as it must at this procedural stage), the factual allegations on which Counts I largely rests are (1) changed wheat prices, and (2) excerpts of two emails. These allegations, however, do nothing to inform the Court or Kraft of *how* Kraft allegedly deceived the market. They do not, for example, suggest that Kraft made any statement (much less a false or misleading statement), concealed its conduct, or in any way signaled its allegedly fraudulent intent in an effort to trick the market. In the absence of such allegations, Kraft is left to defend itself against a serious charge without any notice of how its conduct was allegedly fraudulent. A fraud charge lacking that particularity must be dismissed.

Similarly, Count II of the Complaint, brought under the CFTC's traditional (and restrictive) anti-manipulation authority, also fails to state a claim. That claim requires the CFTC to allege facts, such as an "artificial price" and a specific intent to create that artificial price, that

are necessarily missing from a case in which a consumer of wheat is merely attempting to obtain wheat at market-based prices.

In short, the CFTC's case comes down to this: when faced with higher wheat prices in one market and lower wheat prices in another, Kraft was required by law to purchase wheat in the more expensive market. According to the CFTC, to do otherwise is a fraud and a manipulation. The Commission can make this claim only by distorting its antifraud and anti-manipulation authorities beyond their statutory contours. The CFTC has therefore failed to state a claim as to Counts I and II. Those Counts should be dismissed.

SUMMARY OF FACTS

Stripped of its many conclusory allegations, which are "not entitled to the presumption of truth" for purposes of Rule 12(b)(6), *Smoke Shop, LLC v. United States*, 761 F.3d 779, 784 (7th Cir. 2014), the Complaint alleges few facts relevant to Counts I and II. The handful of factual allegations that remain tell a straightforward story of a snack-food company doing the best it could to purchase wheat at sound prices in a difficult market.

A. Kraft requires a large and steady supply of wheat to produce its snack foods.

This case is unusual for a number of reasons, beginning with the identity of the defendant. Unlike the target of a typical CFTC action, Kraft, headquartered in Northfield, Illinois, is one of the country's largest food companies, producing iconic brands such as Oscar Mayer, Jell-O, and Kraft Singles. Also unlike a typical CFTC defendant, Kraft is a commodity end-user. Compl. ¶¶ 8, 45.[2] Thus, Kraft does not speculate in the commodities markets; instead, it actually *uses* commodities to make products that it sells to consumers.[3] ¶ 11. Many of Kraft's

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[2] All citations in this brief preceded by "¶" are citations to the Complaint.

[3] The commodity at issue in this case—soft red winter wheat #2—is critical to many of the snack foods Kraft produces. Soft red winter wheat is one of "five basic types of wheat grown in the United States." Senate Perm. Subcomm. on Investigations, *Excessive Speculation in the Wheat Market* at 22 (June 24,

products—such as Oreos, Chips Ahoy!, Ritz, Triscuits, and Wheat Thins—require large amounts of flour, which Kraft mills from the wheat it purchases. *Id.* The Company consumes 30 million bushels of wheat a year, equaling approximately 2.5 million bushels a month. ¶ 11. Consequently, procuring a steady supply of wheat at economically-sound prices is critical to keeping Kraft's mills operating and to maintaining affordable prices for consumers.

Kraft traditionally satisfies this demand by acquiring wheat in the cash market.[4] ¶¶ 14-15. To protect itself from changes in the price of cash wheat, Kraft, like other commodity end-users, uses the futures markets to hedge against adverse price changes in the cash wheat market.[5] ¶ 23. Thus, the Company's activities in the wheat futures market typically involve purchasing "long" wheat futures that match its anticipated wheat needs.[6] ¶ 18. In effect, Kraft uses the futures markets to lock in the price of wheat if it perceives wheat prices to be favorable today and wishes to protect itself from the risk that wheat will be more costly in the future. If the price of wheat in the future is approximately what was anticipated at the time Kraft purchased its long

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2009) [hereinafter "Senate Wheat Market Report"]. *See also Menominee Indian Tribe of Wis. v. Thompson*, 161 F.3d 449, 456 (7th Cir. 1998) ("A court may consider judicially noticed documents without converting a motion to dismiss into a motion for summary judgment. Judicial notice of historical documents, documents contained in the public record, and reports of administrative bodies is proper.") (citations omitted). Unlike other varieties of wheat, soft red winter wheat's protein and gluten content make it ideal "for products that do not need to stick together well, such as crackers and cookies." *Senate Wheat Market Report* at 23. The U.S. Department of Agriculture further divides wheat into five grades—of which #2 wheat is one example—based on a variety of factors. *See* 7 C.F.R. § 810.2204(a).

[4] The "cash market" for wheat "exists wherever a grain elevator, grain merchant, grain consumer, or other participant in the grain industry posts a price to purchase or sell grain. Cash transactions take place all over the country, at all times of the day, either with or without the use of standardized contracts." *Senate Wheat Market Report* at 4.

[5] *See generally id.* at 54-59 (providing an example of how hedging helps manage price risk).

[6] A "long" wheat futures contract is a standardized agreement to buy a predetermined quantity of wheat "at a price that is determined at the initiation of the contract" at some predetermined date in the future. ¶ 18. The standardized futures contract for soft red winter wheat specifies that the wheat underlying the contract will be delivered in one of five months: March, May, July, September, and December. *See* CBOT Rule 14102. However, holding a long wheat futures contract does not necessarily mean that the holder will take delivery under the contract; a futures contract may, instead, be "'offset' by entering an equal and opposite trade, effectively eliminating the original position." ¶ 18.

futures contracts, Kraft purchases its wheat in the cash market and then purchases offsetting "short" futures contracts (the opposite of a long futures contract (*id.*)) to unwind the hedge. ¶ 23.

This strategy depends on the cash and futures prices converging as the delivery date draws near.[7] For years, however, the price of wheat futures contracts has failed to converge with the price of cash wheat, resulting in a market in which "the relationship between the futures and cash prices for wheat has become unpredictable." *Senate Wheat Market Report* at 3.[8]

B. Kraft sought to procure wheat in late 2011 at economically-sound prices.

Given these market conditions, the summer and fall of 2011 were particularly challenging for Kraft, as the traditional source of its wheat supply—the cash market—saw rising prices. ¶ 24. Kraft, therefore, had to consider using the futures market, not just to hedge its cash prices, but also to source wheat through the futures delivery process.

Kraft, however, had not taken delivery on a wheat futures contract in nearly a decade. ¶ 23. Thus, to ensure doing so would be feasible, and to familiarize itself with the process, Kraft conducted a trial run in September 2011. As it began taking delivery, Kraft obtained some wheat from locations near its Toledo mill, and some wheat from farther distances. *Id*. Kraft therefore concluded that the process was, if slightly more cumbersome, certainly feasible given the costly alternative of purchasing cash wheat.

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[7] *See Senate Wheat Market Report* at 61. "If these two markets converge [at the time of delivery], then farmers, elevators, and other hedgers can reliably anticipate their net gains (and losses) at the time they initiate a hedge." *Id.* However, "if the two markets do not converge in a predictable manner,"—as has often been true of the wheat market—"then hedgers are unable to anticipate their net gains or losses from the hedging strategy and lose the ability to protect themselves from price fluctuations." *Id.*

[8] The failure of the price of wheat futures to converge with the price of cash wheat is a well-known phenomenon. Congress, for example, has been well aware of, and has studied, this problem. *See id.* at 8 ("[I]ncreasingly, the wheat futures prices on the Chicago exchange have not converged with the cash prices at the expiration of the futures contracts.") So too has the U.S. Department of Agriculture (USDA Econ. Res. Svc., EIBN 115, *Non-Convergence in Domestic Commodity Futures Markets: Causes, Consequences, and Remedies* (Aug. 2013), *available at* http://www.ers.usda.gov/media/1157033/eib115.pdf), and, of course, the CFTC. *See Excessive Speculation in the Wheat Market: Hearing Before the S. Perm. Subcomm. on Investigations*, S. Hrg. 111-155 at 16 (testimony of Gary Gensler, Chairman, CFTC).

By October, cash prices were still high, and Kraft still needed to obtain wheat. As Kraft's Senior Director of Global Procurement explained to Kraft's Senior Vice President of Finance, the Company faced a simple economic reality: futures wheat was "50 cents per bushel below the commercially offered price." ¶ 30. Given the size of Kraft's wheat needs, the aggregate impact of a 50 cent-per-bushel price difference was approximately $7 million. *Id*. Kraft thus acted as would any rational business: it used the futures market to ensure it had a source of wheat.

Kraft then spent several months preparing to take delivery of December 2011 wheat futures. Kraft senior management, however, concerned about expending a large amount of cash at year's end, "required that the futures position could not exceed $50 million by the end of December." ¶ 31. Given the cash-flow impact of its proposal, the Company's procurement department accordingly agreed to reduce Kraft's wheat futures position to $50 million by the end of December.[9] *Id*. Having built up its position of long wheat futures, Kraft began standing for delivery at the end of November. ¶ 35.

Kraft took delivery of shipping certificates for 6.6 million bushels of wheat—almost 42% of its long position—at the end of November and the first few days of December.[10] ¶ 38. In just a few days' time, Kraft "loaded out" (i.e., tendered its shipping certificates for wheat) 660,000

[9] Kraft had several options available to reduce the cash flow impact of its long position. These options included rolling the futures position to a later contract month by, for example, selling December futures and buying March futures, giving Kraft the option of standing for delivery in March if necessary. *See* CFTC Glossary: Roll-over, *available at* http://www.cftc.gov/ConsumerProtection/EducationCenter/CFTCGlossary/index.htm#R (last visited May 29, 2015).

[10] Taking delivery of a shipping certificate is the first step in ultimately taking physical delivery of wheat. The certificate "represents an interest in wheat for load-out from a [Chicago Board of Trade]-approved delivery facility." ¶ 19. As the CFTC notes, shipping certificates "may also be bought and sold between traders or exchanged for futures positions" (¶ 19) as, for example, when a purchaser receives shipping certificates for load-out from undesirable locations and wishes to trade for certificates allowing load-out from more desirable locations.

bushels of wheat, representing approximately 26% of its monthly demand. ¶¶ 11, 38. However, it soon became unnecessary to continue taking physical delivery of futures wheat. As Kraft began taking delivery, the spread (i.e., the price difference) between December 2011 and March 2012 wheat futures shrank and, consequently, wheat warehouses no longer had an incentive to store wheat with the expectation of selling it at higher prices in March. *See* ¶¶ 36, 40.

Kraft procurement personnel had "anticipate[d]" that the laws of supply and demand should result in the price for wheat going down in one market when demand for wheat was satisfied from another, less costly market. ¶¶ 30, 36. As the Company's Senior Director of Global Procurement noted in an email, "[i]n addition" to Kraft's primary concern of obtaining wheat at a savings of approximately $7 million, if what was anticipated actually occurred, Kraft would "have the option of redelivering the wheat acquired through the futures market." ¶ 30. By redelivering or reselling the futures wheat, Kraft could "reverse the negative cash flow impact" for the Company when it had to pay for the wheat it took delivery of. *Id.* What was anticipated became reality, and Kraft made a business decision—as would any rational business whose livelihood depends on maintaining a steady supply of a fungible commodity—to close out its remaining futures positions and purchase wheat in the cash market. ¶ 39. In effect, the cash wheat market saw legitimate demand that was being satisfied in a competing market. The result was what one would expect: the cash price began to fall, and the prices for cash and futures wheat began to converge. ¶ 40.

ARGUMENT

I. Standard of Review

The Court's standard of review is familiar. A complaint survives a motion to dismiss under Rule 12(b)(6) only where "the plaintiff pleads factual content," accepted as true, "that allows the court to draw the reasonable inference that the defendant is liable for the misconduct

alleged." *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009). This standard is not satisfied when "a complaint pleads facts that are merely consistent with a defendant's liability." *Id.* (internal quotation marks and citations omitted). The complaint must therefore "rais[e] th[e] possibility [of relief] above a 'speculative level.'" *EEOC v. Concentra Health Svcs., Inc.*, 496 F.3d 773, 776 (7th Cir. 2007) (quoting *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 555 (2007)).

This standard is even more demanding when, as with Count I, the plaintiff charges the defendant with fraud. (As discussed at pages 10-11 below, Count I charges Kraft with violating the CFTC's new fraud-based anti-manipulation rule and thus is subject to Federal Rule of Civil Procedure 9(b)'s heightened pleading requirement.) To adequately plead fraud, Rule 9(b) provides that the plaintiff "must state with particularity the circumstances constituting fraud." Fed. R. Civ. P. 9(b). This requires that "a plaintiff ordinarily must describe the who, what, when, where, and how of the fraud—the first paragraph of any newspaper story." *Pirella Armstrong Tire Corp. Retiree Med. Ben. Trust v. Walgreen Co.*, 631 F.3d 436, 441-42 (7th Cir. 2011) (internal quotation marks omitted).

As explained below, the facts alleged in support of Counts I and II of the Complaint fail to meet these standards. Those Counts should therefore be dismissed.

II. Count I should be dismissed because the CFTC's allegation that prices changed as a result of Kraft's bona fide transactions is insufficient to infer that Kraft deceived or manipulated the market.

The Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, 124 Stat. 1376 (2010), gave the CFTC the authority to prohibit fraudulent activities in the commodities markets undertaken by "any manipulative or deceptive device or contrivance, in contravention of such rules and regulations as the Commission shall promulgate." *Id.* § 753, 124 Stat. at 1750-51 (codified at 7 U.S.C. § 9(c)(1)). Count I of the Complaint presents the first occasion for any court to interpret the CFTC's new authority.

This authority, § 6(c)(1) of the Commodity Exchange Act (CEA), is based almost entirely on the Securities Exchange Act of 1934's antifraud provision, § 10(b), 15 U.S.C. § 78j. Given the similarities between § 10(b) and § 6(c)(1) (along with the statutes' respective implementing rules, SEC Rule 10b-5 and CFTC Rule 180.1),[11] the Court should look to § 10(b) and Rule 10b-5 caselaw to give substance to § 6(c)(1) and Rule 180.1. When doing so, however, it is important that the Court consider, as discussed below, ways in which the commodities and securities markets differ.

In light of this law and these considerations, a claim under Rule 180.1 requires the CFTC to allege: (1) that Kraft committed a manipulative or deceptive act, either by misrepresenting some specifically identified fact or by injecting false information into the market, *see Sullivan & Long, Inc. v. Scattered Corp.*, 47 F.3d 857, 865 (7th Cir. 1995); *In re Olympia Brewing Co. Sec. Litig.*, 613 F. Supp. 1286, 1292 (N.D. Ill. 1985); and (2) that Kraft did so with scienter. *See Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 197 (1976). For the reasons discussed below, the CFTC has not alleged facts from which the Court can plausibly infer either element of the CFTC's Rule 180.1 claim. Count I must therefore be dismissed.

A. The CFTC has failed to plead with particularity facts from which the Court can infer that Kraft deceived or misled the market.

Rule 180.1 prohibits manipulative and deceptive *activities*; it does not prohibit failing to disclose one's trading strategies. Any other interpretation would be inconsistent with the language of Rule 180.1, conflict with the law in this Circuit interpreting Rule 10b-5, and chill entirely legitimate transactions in the nation's commodities markets.

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[11] The texts of § 6(c)(1) and § 10(b), together with their corresponding rules, are set out in the attached Statutory and Regulatory Appendix.

Count I falters on this basic premise. The CFTC is unable to identify and plead, with the particularity required for a fraud charge, what "manipulative or deceptive device or contrivance" Kraft allegedly "employ[ed]." CEA § 6(c)(1). The Complaint does not allege conduct by which Kraft purportedly misled, deceived, or tricked the market. Indeed, the Complaint does not allege that Kraft communicated anything at all. Count I must therefore be dismissed.

1. The CFTC must satisfy the heightened pleading standard of Federal Rule of Civil Procedure 9(b) to state a claim for a violation of an antifraud rule such as Rule 180.1.

A Rule 180.1 charge is an allegation of fraud and, as such, is subject to the heightened pleading requirement of Federal Rule of Civil Procedure 9(b). It is well established that "[a]llegations of fraud under Rule 10b-5 must satisfy the requirements of Federal Rule of Civil Procedures 9(b) to survive a motion to dismiss." *Rehm v. Eagle Fin. Corp.*, 954 F. Supp. 1246, 1251 (N.D. Ill. 1997). Because Rule 180.1 is nearly identical to Rule 10b-5, allegations under Rule 180.1 must also be pled with the particularity required by Rule 9(b). (In its notice of final rulemaking for Rule 180.1, the CFTC implicitly acknowledged this point, stating that "Final Rule 180.1 prohibits fraud and fraud-based manipulations." *Final Rule: Prohibition on the Employment or Attempted Employment of Manipulative and Deceptive Devices and Prohibition on Price Manipulation*, 76 Fed. Reg. 41,398, 41,400 (July 14, 2011).) *See also In re Amaranth Nat. Gas Commodities Litig.*, 730 F.3d 170, 181 n.11 (2d Cir. 2013) (suggesting that a heightened pleading standard applies to Rule 180.1); *Borsellino v. Goldman Sachs Grp., Inc.*, 477 F.3d 502, 507 (7th Cir. 2007) (noting that "[a] claim that sounds in fraud . . . can implicate Rule 9(b)'s heightened pleading requirements") (internal quotation marks omitted).

Thus, the CFTC must plead its Rule 180.1 charge with particularity, stating, among other things, "what manipulative acts were performed." *SEC v. U.S. Environmental, Inc.*, 82 F. Supp. 2d 237, 240 (S.D.N.Y. 2000) (interpreting Rule 10b-5). *See also Pirella*, 631 F.3d at 441-42.

2. Because Kraft engaged in bona fide commodities transactions, Rule 180.1 requires the CFTC to allege that Kraft engaged in manipulative or deceptive conduct.

Count I fails to state a claim because the Complaint does not inform the Court or Kraft of the "manipulative or deceptive device or contrivance" that Kraft is alleged to have "employ[ed]." CEA § 6(c)(1). The facts relevant to Count I make only one thing clear by their omission: the CFTC does not allege that Kraft engaged in classic forms of market manipulation, "such as wash sales, matched orders, or rigged prices, that are intended to mislead investors by artificially affecting market activity." *Santa Fe Indus. v. Green*, 430 U.S. 462, 476-77 (1977) (interpreting § 10(b) and Rule 10b-5). In the absence of such claims, the CFTC must allege facts from which the Court can infer that Kraft "engaged in market activity aimed at deceiving investors as to how other market participants have valued a [commodity]." *ATSI Commc'n, Inc. v. Shaar Fund, Ltd.*, 493 F.3d 87, 100 (2d Cir. 2007). The CFTC must, in other words, allege some deceptive act or practice.

The standard in this Circuit is the same for similar claims under Rule 10b-5. In cases where an alleged manipulator engaged in bona fide transactions (that is, not wash sales, matched orders, or the like), the Seventh Circuit has held that no manipulation occurs where the defendant "made no representations, true or false, actual or implicit" concerning the manner in which the defendant intended to act. *Sullivan & Long, Inc. v. Scattered Corp.*, 47 F.3d 857, 864 (7th Cir. 1995). Thus, to state a claim for manipulation in a case involving bona fide transactions, the Seventh Circuit requires "proof of either deception or manipulation." *Id.* at 864-65. Other courts similarly require some outward manifestation of the defendant's alleged fraud—allegations, for example, that "the alleged manipulator injected 'inaccurate information' into the market or created a false impression of market activity." *GFL Advantage Fund, Ltd. v. Colkitt*, 272 F.3d 189, 205 (3d Cir. 2001) (citing *Santa Fe Indus.*, 430 U.S. at 477). *See also In re Olympia*

Brewing Co. Sec. Litig., 613 F. Supp. 1286, 1292 (N.D. Ill. 1985) ("[I]t is clear that the essential element of the claim [of market manipulation under Rule 10b-5] is that *inaccurate* information is being injected into the marketplace."). Although they each state the rule somewhat differently, the import of cases such as *Sullivan & Long*, *Olympia Brewing*, and *GFL Advantage Fund* is clear: a manipulation claim under Rule 10b-5 requires that the plaintiff allege that the defendant engaged in manipulative or deceptive conduct.

To interpret Rule 180.1 in this case (where, as with the defendants in *Sullivan & Long*, *Olympia Brewing*, and *GFL Advantage Fund*, Kraft engaged in bona fide transactions), the Court should adopt the same rule. As explained above, such a rule requires the plaintiff to allege that the defendant represented something and that the representation was false (as in *Sullivan & Long*) or that the defendant "injected inaccurate information" into the market (as in *GFL Advantage* and *Olympia Brewing*). This rule has several benefits.

First, by requiring proof of an outward manifestation of the defendant's alleged fraud, *Sullivan & Long*, *Olympia Brewing*, and *GFL Advantage* adhere to the language of Rule 10b-5 and, by extension, Rule 180.1. The subsections of Rule 180.1 which the CFTC alleges Kraft violated prohibit—in language taken nearly verbatim from Rule 10b-5—the use of a "manipulative device, scheme, or artifice to defraud" or "any act, practice, or course of business, which operates or would operate as a fraud or deceit upon any person." Rule 180.1(a)(1), (3). Rule 10b-5's parallel provisions have been interpreted to require, among other things, allegations "that inaccurate information is being injected into the marketplace," *Olympia Brewing Co.*, 613 F. Supp. at 1292 (emphasis omitted), or allegations of "a deceptive or manipulative act." *Last Atlantis Capital LLC v. AGS Specialist Ptrs.*, 749 F. Supp. 2d 828, 832 (N.D. Ill. 2010). *See also Sullivan & Long*, 47 F.3d at 864-65; *Matter of Lake States Commodities, Inc.*, 936 F. Supp. 1461,

1472 (N.D. Ill. 1996) ("[T]he schemes and practices prohibited by 10b-5 are necessarily those of a *fraudulent* nature."), *rev'd on other grounds by Damato v. Hermanson*, 153 F. 3d 464 (7th Cir. 1998).

Second, by establishing a relatively bright line between legal and illegal conduct, this rule serves the practical function of allowing "courts to differentiate between legitimate trading activities that permissibly may influence prices . . . and 'ingenious devices that might be used to manipulate securities prices.'" *GFL Advantage Fund, Ltd.*, 272 F.3d at 205 (quoting *Santa Fe Indus.*, 430 U.S. at 477). In other words, applying *Sullivan & Long*, *Olympia Brewing*, and *GFL Advantage* to Rule 180.1 allows courts (and regulated parties) to more easily identify what Rule 180.1 prohibits. This is particularly important in cases such as this one, in which the defendants engaged in entirely legitimate transactions.

Third, requiring the CFTC to allege some outward manifestation of the defendant's fraud is consistent with the general nature of the commodities markets. Unlike the securities markets, in which all or most market participants have equal access to relevant information concerning the price of a security, "[n]umerous futures market participants may have legitimate access to what some may perceive as superior information." CFTC, *A Study of the Nature, Extent and Effects of Futures Trading by Persons Possessing Material, Nonpublic Information*, Report to the House Comm. on Ag. & the Sen. Comm. on Ag., Nutrition, and Forestry, at 53 (Sept. 1984). Thus, as the CFTC recognizes, "hedgers," such as Kraft, "who comprise a substantial portion of the [commodities] markets, also participate in the production, processing, distribution and/or consumption of the cash commodity underlying the futures market." *Id.* Accordingly, "[b]y the nature of their businesses, many hedgers are privy to nonpublic information that may prove to be material in futures markets." *Id.*

The result is that the commodities markets, unlike the securities markets, are prone to price fluctuations caused by nothing more than legitimate trading on information that is known only to the trader. If the CFTC is not required to allege some outward manifestation of fraud as part of Rule 180.1, a whole swath of perfectly legitimate and legal conduct in the commodities markets would come under cloud based on nothing but price fluctuations and a trader's pursuit of its legitimate business interest. Thus, interpreting Rule 180.1 to require an outward manifestation of fraud is necessary to comport with the CFTC's pronouncement that Rule 180.1 "will not affect market participants engaged in legitimate market activity undertaken in good faith." 76 Fed. Reg. at 41,405.

3. Count I should be dismissed because the CFTC has not alleged, with any degree of particularity, how Kraft engaged in allegedly deceptive or manipulative conduct.

The CFTC has not pled with particularity facts from which the Court could reasonably infer that Kraft misrepresented its intent in purchasing long wheat futures or "inject[ed]" false information into the market. Thus, nothing in the Complaint plausibly suggests that Kraft deceived the market as is required by Rule 180.1.

In several conclusory paragraphs the CFTC alleges that Kraft used "its status as a commercial hedger to acquire a huge long position in December 2011 wheat futures in order to induce sellers to believe that Kraft would take delivery, load out, and use that wheat in its Mill" (¶ 25); that Kraft "acquired its December 2011 long position without any intention of loading out, delivering, and using the majority of the CBOT wheat it stood to acquire" (¶ 26); and that Kraft "desired to make the market believe that it would take delivery, load out, and store that wheat for use in the Mill" when it allegedly actually "intended for the market to react to its long position by lowering the price of cash wheat available in the Toledo area." (¶34).

These statements, however, are wholly insufficient to allege with particularity "proof of either deception or manipulation." *Sullivan & Long*, 47 F.3d at 865. Because Rule 180.1 is an antifraud rule, Federal Rule of Civil Procedure 9(b) requires the CFTC to allege, among other things, "the . . . how of the fraud." *Pirella*, 631 F.3d at 441-42. The Complaint does not offer any facts showing "how" Kraft allegedly misled the market as to how it meant to use wheat futures. Instead, the Complaint simply assumes that the market would understand that Kraft would take delivery. Particularly when this allegation is the cornerstone of the CFTC's Rule 180.1 charge, the CFTC's assumption that the market believed that Kraft would take delivery cannot be sufficient to satisfy Rule 9(b)'s heightened pleading requirement. Rule 9(b), after all, "does not allow the pleader merely to suggest fraud has occurred and then to assume the opponent can construct the details." *Allendale Mut. Ins. Co. v. Bull Data Sys.*, 91 C 6103, 1992 WL 159334, at *11 (N.D. Ill. Jun. 30, 1992).

The CFTC must instead allege *something* suggesting that the market allegedly received a message from Kraft, in some particularly identified form, that was different from Kraft's alleged true intent. The Complaint offers nothing on this point. The mere fact that Kraft established a large long position in December 2011 wheat futures cannot, in and of itself, be the method by which Kraft allegedly misled the market. *Cf. Olympia Brewing*, 613 F. Supp. at 1296 ("[T]he court reminds plaintiffs that short selling is simply not unlawful, even in large numbers and even if the trading does negatively affect the purchase price. Where the trading volume and price simply reflect supply and demand based on accurate market information, this is lawful market behavior, not market manipulation."); *GFL Advantage Fund*, 272 F.3d at 207 (making a similar point). Given that a holder of a long futures contract can satisfy its contractual obligations in multiple ways (¶ 18), the CFTC's allegations concerning Kraft's large long position cannot

plausibly be interpreted as any sort of signal or statement to the market as to Kraft's intentions. That is, assuming that merely holding a large long position could signal anything (a point Kraft does not concede), the market could have interpreted Kraft's large long position in a number of ways. For example, Kraft's long position could indicate that Kraft would take delivery of all or some of its futures position (*id.*); that Kraft would offset or roll some of its position to a later contract month (*id.*); that Kraft would accept shipping certificates that it would then trade for certificates entitling Kraft to wheat from different locations (¶ 19); that Kraft would re-sell its shipping certificates (¶ 38); or that Kraft would redeliver futures wheat (¶30). The Complaint contains no allegation that Kraft communicated in any way that it would pursue only one of these multiple options. Thus, simply alleging that Kraft held a large long position is insufficient to plead with particularly that Kraft signaled its intentions to the market.

In addition, the Complaint does not allege that Kraft made any explicit or implicit statements regarding its intentions, separate from whatever signal its large long position allegedly conveyed. Instead of alleging that Kraft injected false information into the market or made misrepresentations concerning its alleged true intentions, the Complaint's allegations focus almost exclusively on Kraft's internal deliberations (as well as completely irrelevant topics, such as wheat quality). These allegations, however, do nothing to demonstrate what Kraft did to allegedly mislead the market. Likewise, they do not—and cannot—suggest that Kraft had a duty to disclose its alleged intention. *See Sullivan & Long*, 47 F.3d at 863 (rejecting plaintiffs' allegation of "deception" based on an alleged failure to disclose where defendant "was not required to disclose"); *Chiarella v. United States*, 445 U.S. 222, 228-29 (1980) ("[T]he duty to disclose arises when one party has information that the other [party] is entitled to know because of a fiduciary or other similar relation of trust and confidence between them.") (internal

quotation marks omitted) (second modification in original). Kraft—as well as the Court—is therefore left to guess what, exactly, the alleged "manipulative or deceptive device or contrivance" was. CEA § 6(c)(1). This deficiency is entirely contrary to the heightened pleading requirements of Rule 9(b). *See Vicom, Inc. v. Harbridge Merchant Svcs., Inc.*, 20 F.3d 771, 777-78 (7th Cir. 1994) (noting that "fair notice is '[p]erhaps the most basic consideration underlying Rule 9(b)'") (quoting Wright & Miller § 1298 at 648) (modification in original).

Finally, to permit a fraud allegation based only on bona fide trading and price movement consistent with that trading expands Rule 180.1's reach far beyond what the Seventh Circuit allows in the Rule 10b-5 context. *See Sullivan & Long*, 47 F.3d at 861 ("[W]e would think twice before concluding that [the federal securities] laws prohibit 'schemes' that accelerate rather than retard the convergence between the price of a stock and its underlying economic value and therefore promote rather than impair the ultimate goals of public regulation of the securities markets.") Simply put, to state a claim under Rule 180.1 that satisfies Rule 9(b)'s heightened pleading standard, the CFTC must allege that Kraft did *something* that misled the market, and not simply that the market drew certain conclusions from Kraft's conduct. *See SEC v. U.S. Environmental, Inc.*, 82 F. Supp. 2d at 240 ("To satisfy Rule 9(b), a market manipulation claim [under Rule 10b-5] must specify *what manipulative acts were performed* . . . .") (emphasis added) (internal quotation marks omitted). On this basis, the Court should dismiss Count I.

B. The CFTC has failed to allege facts from which the Court can infer scienter.

In addition to pleading fraudulent conduct, Rule 180.1 requires the CFTC to allege scienter, i.e., "intent to deceive, manipulate, or defraud." *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 192 (1976). Section 6(c)(1) authorizes the CFTC to issue a rule making it "unlawful for any person, directly or indirectly, to use or employ, or attempt to use or employ . . . any manipulative device or contrivance." CEA § 6(c)(1). This language sets a high floor for scienter; as the

Supreme Court has recognized, "[t]he words 'manipulative or deceptive' used in conjunction with 'device or contrivance' strongly suggest that [§ 6(c)(1)] was intended to proscribe knowing or intentional misconduct." *Ernst & Ernst*, 425 U.S. at 197 (interpreting § 10(b)).

Nonetheless, Rule 180.1 prohibits both "intentional[]" and "reckless[]" conduct. 17 C.F.R. § 180.1(a). As discussed below, however, there is little functional difference between "intentional" and "reckless" conduct under Rule 180.1. Caselaw interpreting Rule 10b-5, on which Rule 180.1 is modeled, treats intentionality and recklessness largely as alternative methods for proving the same thing. The CFTC has failed to allege facts satisfying this standard.

1. Rule 180.1's "reckless[]" standard should be interpreted as the equivalent of intent.

Rule 180.1's "reckless[]" standard should be interpreted, like § 10(b), to prohibit only conduct that is "the functional equivalent of intent." *Sundstrand Corp. v. Sun Chem. Corp.*, 553 F.2d 1033, 1045 (7th Cir. 1977) (interpreting "recklessness" under Rule 10b-5). Under this standard, "reckless" conduct

> [M]ay be defined as a highly unreasonable omission, involving not merely simple, or even inexcusable negligence, but an extreme departure from the standards of ordinary care, and which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have known it.

Id. (internal quotation marks omitted). Thus, under this heightened standard, recklessness "may serve as a surrogate concept for willful fraud," *Rolf v. Blyth, Eastman Dillon & Co., Inc.*, 570 F.2d 38, 46 (2d Cir. 1978), and is merely an alternative method of proving intent. *See id.* ("[T]here is general agreement that ['intent to mislead'] is present when the representation is made without any belief as to its truth, or with reckless disregard whether it be true or false.") (quoting W. Prosser, Law of Torts § 107, at 700 (4th ed. 1971)). *See also SEC v. Jakubowski*, 150 F.3d 675, 681 (7th Cir. 1998) (noting that under *Sundstrand*, *supra*, "reckless disregard of the truth counts as intent" under Rule 10b-5).

The standard set forth above is the only way to interpret Rule 180.1's "reckless[]" standard in a manner consistent with the authorizing language of § 6(c)(1).[12] Once again, § 6(c)(1)'s operative language sets a high bar for scienter—the word "manipulative" in § 6(c)(1) "is and was virtually a term of art when used in connection with the securities markets. It connotes intentional or willful conduct designed to deceive or defraud investors by controlling or artificially affecting the price of securities." *Ernst & Ernst*, 425 U.S. at 199. Thus, interpreting the word "reckless" as the Seventh Circuit and other courts have in Rule 10b-5 cases—that is, as extreme recklessness, or simply as an alternative way of proving intent—will keep Rule 180.1 within the bounds of the Congress's authorizing statute.

2. The CFTC has failed to allege scienter.

The CFTC's allegations of scienter do not meet the high bar for intent or its functional equivalent, extreme recklessness. The CFTC's scienter allegations first fail because the Complaint does not allege "facts from which a court may reasonably infer that a party acted with the requisite state of mind." *Triteq Lock & Sec. LLC v. HMC Holdings LLC*, No. 11 C 843, 2011 WL 2648592 at *4 (N.D. Ill. July 5, 2011). Once again, the Complaint does not allege that Kraft made any statements to the market regarding its intentions (from which the Court might infer ill-motive), nor does the Complaint allege that Kraft omitted to state its intentions despite a duty to do so. In the absence of such allegations, and given the fact that Kraft had multiple options afforded by virtue of its long futures position,[13] the Court cannot infer that Kraft signaled its alleged intentions to the market. Thus, particularly in light of Kraft's rational response to

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[12] It is also consistent with the CFTC's interpretation of Rule 180.1's scienter requirement. *See* 76 Fed. Reg. at 41,404 n.87 (July 14, 2011) (citing *Sunstrand* to define "recklessly" in Rule 180.1)

[13] As noted above, Kraft could have chosen to take delivery of all or some of its futures position (¶ 18); offset or roll some or all of its position (*id.*); accept shipping certificates that it might then trade for certificates entitling Kraft to wheat from different locations (¶ 19); re-sell its shipping certificates (¶ 38); or redeliver futures wheat (¶ 30).

changed market conditions, the Complaint does not allege facts from which the Court can plausibly infer scienter.

In addition, the CFTC fails to adequately allege scienter because its few allegations in support of scienter are all conclusory. *See, e.g.*, ¶¶ 25, 26, 34. Although Rule 9(b)'s particularity requirement does not apply to mental states, "there must still be 'some basis for believing the plaintiff could prove *scienter*.'" *SEC v. Steffes*, 805 F. Supp. 2d 601, 618 (N.D. Ill. 2011). The CFTC's conclusory allegations concerning scienter must, therefore, be "adequately supported by other facts alleged in the complaint" to state a claim. *Id.* In support of its conclusory allegations, the CFTC offers several scattershot factual allegations concerning wheat quality (¶ 20), the location of futures wheat (¶ 37), the amount of cash wheat Kraft purchased in December 2011 (¶ 39), and storage costs for any futures wheat Kraft could not store itself (¶ 33).[14] What all of these allegations ignore, however, is that Kraft *did* take delivery of 660,000 bushels of wheat before beginning to purchase cheaper cash wheat. ¶ 38. In other words, the Complaint's factual allegations concerning scienter are internally inconsistent—if futures wheat were really of lower quality, if it really were shipped from further distances, and if it really did need to be stored somewhere else, why would Kraft have taken delivery of any of the wheat it received? Conversely, yet equally inconsistent, why would Kraft's alleged scheme have relied on the market assuming Kraft would take delivery of 15 million bushels of wheat if Kraft allegedly could not have used or stored that wheat? These glaring inconsistencies show that, even when viewed in the light most favorable to the CFTC, the Complaint does not allege sufficient facts

[14] These last two factual allegations are especially puzzling. Although the CFTC suggests that there is some relevance to whether Kraft could itself store $90 million worth of futures wheat, the Complaint alleges that Kraft could have stored this wheat "for approximately five cents per bushel." ¶ 33. However, at the time, the cost of futures wheat was 50 cents per bushel less than the cost of cash wheat. ¶ 30. Thus, even with a five-cent-per-bushel storage cost, futures wheat would have still been far cheaper than cash wheat.

from which the Court may infer that Kraft intended to manipulate the price for wheat futures. In short, these inconsistencies show the implausibility of the CFTC's allegations of scienter.

Lastly, the only factual allegations on which the CFTC bases its scienter claim—excerpts of two emails—demonstrate that Kraft *did*, in fact, intend to use the futures market to satisfy its unquestioned need for wheat and, thus, could not have intended to mislead or deceive the market. For example, the October 20, 2011 email cited by the CFTC begins: "Given our proposal *to take physical delivery* in Dec[ember] of 15mm bushels at 50 cents per bushel below the commercially offered price results in the savings of $7mm+." ¶ 30 (internal quotation marks omitted) (emphasis added). The December 2, 2011 email likewise notes that "we established a long Dec Wheat/Short March Wheat spread at 35 cents . . . *for the purpose of taking delivery of [Chicago Mercantile Exchange] wheat, representing a $7MM+ saving over commercially sourced wheat.*" ¶ 36 (emphasis added). The CFTC cannot allege that Kraft did not intend to take delivery of futures wheat when its primary allegations in support of that theory demonstrate that Kraft did, in fact, intend to take delivery of futures wheat. Indeed, it strains Rule 8(a)'s "plausibility" standard, *Iqbal*, 556 U.S. at 678, to suggest that Kraft did not intend to source wheat from the futures market when, for the first time in nearly a decade, it *did* take delivery of wheat futures in its trial run. The Complaint offers no explanation for why Kraft would have conducted such an unusual exercise if it did not actually intend to take delivery of and use wheat from futures contracts.

III. Count II should be dismissed because Kraft's attempt to obtain the best wheat price necessarily means Kraft lacked the "ability" or "intent" to create an "artificial price."

In contrast to Rule 180.1, the law governing Count II of the CFTC's Complaint is relatively well-settled. However, as with Count I, Count II of the Complaint fails to state a claim and should be dismissed. Even when viewed in the light most favorable to the CFTC, the facts

alleged in the Complaint are consistent only with a commodity end-user taking legitimate steps to acquire a necessary commodity in the market as it existed at the time. Thus, the CFTC is unable to allege key elements under its traditional anti-manipulation authority.

A. The CFTC has failed to state a claim for completed price manipulation.

The CFTC's traditional anti-manipulation authority, located at § 9(a)(2) of the Commodity Exchange Act, 15 U.S.C. § 13(a)(2), requires proof of four well-established and straightforward elements.[15] The CFTC must allege: (1) that Kraft "had the ability to influence market prices"; (2) that Kraft "specifically intended to do so"; (3) "that artificial prices existed"; and (4) that Kraft "caused the artificial prices." *In re Cox*, CFTC No. 75-16, 1987 WL 106879, at *4 (July 15, 1987). *See also Frey v. CFTC*, 931 F.2d 1171, 1175 (7th Cir. 1991). The CFTC has failed to allege facts from which the Court can infer these elements.

1. The CFTC does not allege Kraft had the "ability" to effect a manipulation.

The Complaint fails to allege that Kraft had the "ability" to execute a manipulation. "Ability" under § 9(a)(2) can take one of several forms, but the CFTC has failed to allege any type of "ability." On this basis alone, the Court should dismiss Count II.

First, "ability" under § 9(a)(2) may exist where the defendant "controlled both the cash and futures market." *In re Soybean Futures Litig.*, 892 F. Supp. 1025, 1046, 1045-56 (N.D. Ill. 1995). Even if a defendant controlled a dominant long futures position (as the CFTC alleges Kraft did (¶ 35)), without also controlling the cash market, the defendant necessarily lacks the

[15] Count II charges Kraft with violating CEA §§ 9(a)(2) and 6(c)(3), together with CFTC Rule 180.2. The relevant law, however, is the same for each. Along with § 6(c)(1), the Dodd-Frank Act added § 6(c)(3) to the CEA. Nonetheless, as the CFTC recognizes, "[w]hile [§ 6(c)(3)] is a new statutory provision, the conduct prohibited is generally prohibited by CEA § 9(a)(2)," 75 Fed. Reg. 67,658 n.8. Likewise, the CFTC recognizes that Rule 180.2, promulgated under new § 6(c)(3), simply "mirrors the statute." *Id.* at 67,660.

ability to manipulate prices because "other market participants can bypass [the defendant's] demands and extinguish their obligations elsewhere." *Cox*, 1987 WL 106879, at *4.

In other words, a trader holding long positions cannot effect a manipulation under § 9(a)(2) unless he has the ability to force shorts to come to him to satisfy their obligations under their futures contracts. Shorts have two choices to satisfy their contractual obligation: they may either "make an equal and opposite transaction ('an offset') in the futures market" or they may "make[] delivery of the commodity itself, as specified in the contract." *Soybean Futures*, 892 F. Supp. at 1032. If a trader controls both the long futures market and the cash market for a commodity, he or she controls the only two avenues—offset and delivery—that a short has for fulfilling its contractual obligations. The holder of a dominant long position can then extract artificially-high prices from shorts desperate to meet their obligations. By contrast, "if there were adequate supplies of deliverable grade wheat available to the shorts to deliver to the longs on the future, [the dominant long] would not be able to extract artificial prices in settlement of its contracts, for rather than paying those prices, shorts would instead procure the wheat and deliver it." *Cargill, Inc. v. Hardin*, 452 F.2d 1154, 1164-65 (8th Cir. 1971).

The CFTC's Complaint contains not a single fact from which the Court can infer that there was in inadequate supply of cash wheat to meet the shorts' obligations, much less that Kraft controlled that supply. To the contrary, the Complaint alleges that "there was sufficient wheat available in the cash wheat market for Kraft to purchase and deliver to the Mill to satisfy Kraft's needs." ¶ 24. Thus, because the Complaint does not at all allege that Kraft controlled the cash wheat market, it contains no factual basis for the first element of a § 9(a)(2) charge.

Second, under a related theory, "ability" may exist where, although the defendant does not control the cash market, it nonetheless is able to "put the shorts in the unsavory position of

dealing with [the defendant] in the face of a known shortage of cash commodities." *Frey*, 931 F.2d at 1177. As above, under this theory of "ability," the holder of a dominant long position can take advantage of a shortage of a physical commodity (caused by a variety of factors, such as weather) to force shorts to sell to the long at artificial prices.

The CFTC, however, does not allege facts suggesting that there was a "known shortage of cash commodities." *Id.* Indeed, once again, the CFTC alleges the opposite: that "there was sufficient wheat available in the cash wheat market for Kraft to purchase and deliver to the Mill to satisfy Kraft's needs." ¶ 24. Thus, the CFTC has not alleged "ability" under this theory.

Third, "ability" to manipulate may exist where the defendant "misle[d] regulators about [its] processing and export requirements" or otherwise injected false information into the market, "thus exaggerating the market's demand for [the relevant commodity] and thereby artificially inflating prices." *Soybean Futures*, 892 F. Supp. at 1046. The CFTC, however, does not allege that Kraft made *any* statements, either publicly or to a regulator, concerning its needs. Indeed, the CFTC has not alleged a single external statement made by Kraft. The CFTC has thus not alleged "ability" under this third and final theory.

2. The CFTC fails to allege that Kraft intended to cause an "artificial price."

The CFTC fails to satisfy the next element of a § 9(a)(2) charge—that Kraft "specifically intended to cause" an alleged "artificial price," *Soybean Futures*, 892 F. Supp. at 1045 (citing *Frey*, 931 F.2d at 1177-78)—for two independent reasons.

First, the Complaint improperly equates knowledge with intent. However, only *intent* to create an artificial price—not *knowledge* that prices will be changed as a result of one's actions—is prohibited by § 9(a)(2). This is a critical distinction that the CFTC attempts to collapse. The Court, however, should reject this effort, because "intentionality and inevitability

are not legally equivalent." *Hershey v. Energy Transfer Ptrs., L.P.*, 610 F.3d 239, 248-49 (5th Cir. 2010). *Cf. In re Rough Rice Commodity Litig.* No. 11 C 618, 2012 WL 473091, at *7 (N.D. Ill. Feb. 9, 2012) ("Mere knowledge that certain actions might have an impact on the futures market is not sufficient to state a private claim under the CEA.")

Taking the CFTC's allegations as true and drawing all reasonable factual inferences in its favor, the Complaint alleges only that Kraft was aware that taking delivery of wheat futures might affect prices for cash and futures wheat. The keystones of the CFTC's Complaint—two emails—suggest, at best, that a declining cash price might result from taking delivery of wheat futures. For example, the first email cited by the CFTC begins by acknowledging a commercial reality: that futures wheat was, at the time, less expensive than cash wheat. ¶ 30. There is nothing sinister, and certainly nothing illegal, about this statement—it is entirely consistent with a commodity end-user trying to obtain its commodity at the best price. This cannot be the basis for an allegation of "specific[] inten[t] to cause artificial price" under § 9(a)(2). *Soybean Futures*, 892 F. Supp. at 1045. After all, as the CFTC recognizes, "seeking the best price for one's commodity is legitimate, indeed critical price-creating force in the futures market that in-and-of-itself cannot be the basis for an inference of manipulative intent." *Indiana Farm Bureau*, 1982 WL 30249 at *9.

The email continues: "*In addition*, there is a key market dynamic that is important to understand: Once the market sees that Kraft is 'stopping' December wheat, *we anticipate* the futures curve will begin to flatten, reducing the profitability of wheat storage, thereby reducing the commercial wheat basis to Kraft." ¶ 30 (emphases added). These statements acknowledge only that an effect on futures prices is a possible byproduct of taking delivery. Indeed, that the effect of taking delivery was noted "[i]n addition" to the email's primary concern (that Kraft

would be able to purchase futures wheat at prices lower than cash wheat) demonstrates that a lower basis was an "anticipate[d]" (*id.*) reality of taking delivery. The email demonstrates, if anything, only knowledge—not intent. However, "entering into a legitimate transaction *knowing* that it will distort the market is not manipulation—only intent, not knowledge, can transform a legitimate transaction into manipulation." *In re Amaranth Nat. Gas Commodities Litig.*, 587 F. Supp. 2d 513, 539 (2008), *rev'd in part on other grds.*, 612 F. Supp. 2d 376, 386-90 (S.D.N.Y 2009).

The CFTC's second email similarly fails to allege specific intent. It once again states only that Kraft's decision to take delivery of wheat had the effect of lowering the cash basis for wheat. ¶ 36 ("As expected, the Dec/Mar spread has narrowed app[roxmiately] 11 cents resulting in a marked to market gain of $3.6MM on our open spread position. Meanwhile, with the narrowing spread, the cash wheat basis has declined from +80 cents to +50 cents over Dec. futures.") Even when viewed in the light most favorable to the CFTC, the quotation from this email alleges, if anything, only an acknowledgement that the cash basis for wheat had decreased. It does not suggest specific intent to create an artificial price in a particular market. This, again, shows nothing more than an understanding of the basic economic effect of Kraft's decision to take delivery of wheat futures, which is not actionable under § 9(a)(2). *See In re Commodity Exch., Inc. Silver Futures & Options Trading Litig.*, No. 11 Md. 2213 (RPP), 2012 WL 6700236, at *11-12 (S.D.N.Y. Dec. 21, 2012) (dismissing § 9(a)(2) claim because, among other reasons, allegations "d[id] not give rise to the inference that [a trader] was acting with the intent of causing artificial price fluctuations within the market . . . as opposed to responding to market opportunities presented during the day").

Second, accepting the Complaint's allegations as true and drawing all reasonable inferences in the CFTC's favor, the Complaint alleges, at most, that Kraft's trading was meant to induce a particular group of local grain elevator operators in Toledo to reduce the surcharge they were applying to the futures price, i.e., the basis. Even if true, such actions constitute local price competition, not market manipulation.

The CEA requires that actionable manipulation be directed at the price of a futures contract or the price of the commodity underlying the futures contract. CEA § 9(a)(2). Conduct that is not specifically intended to affect one of those two market prices, even if related, is not within the scope of the CEA. *See In re Dairy Farmers of Am., Inc.*, No. 9 CR 3690, 2014 WL 4083938, at *41 (N.D. Ill. Aug. 18, 2014) (dismissing action where defendant allegedly tried to impact spot CME cheese prices, noting "[a]lthough spot cheese prices are a 'significant component' in the . . . milk price formula, CME cheese simply is not the underlying commodity in a milk futures contract"); *Hershey*, 610 F.3d at 247 (dismissing action because allegedly manipulative acts were directed at related commodity, not commodity underlying futures contract).

Here, the CFTC's allegations, taken as true, allege trading intended to impact storage and delivery surcharges—i.e., the basis charged by a set of local grain elevators in Toledo—rather than the futures price or the price of the underlying commodity generally. *See* ¶¶ 30, 36, 40. None of these allegations indicate the specific intent to affect prices of the wheat contract or the wheat underlying such contract. Instead, these allegations amount to no more than a commodity end-user demonstrating its willingness to purchase wheat elsewhere if certain suppliers' prices are too high. The CFTC has therefore failed to state a claim as to specific intent to create an artificial price in a commodity or future.

3. The CFTC alleges that futures and cash prices converged, as they should in a properly-functioning futures market and, therefore, resulting prices cannot have been "artificial."

Finally, the CFTC failed to allege facts from which the Court may infer that the result of Kraft's actions was an "artificial price." The Complaint attempts to dodge this issue by equating a "changed" price with an "artificial" price. Only the latter, however, is prohibited by § 9(a)(2). *Cox*, 1987 WL 106879, at *4. *See also In re DiPlacido*, CFTC No. 01-23, 2008 WL 4831204, at *30 (Nov. 5, 2008) ("The Commission has identified one generally applicable factor [to consider in deciding whether a price was 'artificial'], namely, that a statistically high (or low) price will not on that basis alone be deemed artificial.").

A price is "artificial" for purposes of § 9(a)(2) when it "does not reflect the market or economic forces of supply and demand." *Indiana Farm Bureau*, 1982 WL 30249, at *4 n.2. A price, therefore, is artificial only if it does not reflect what a well-functioning market, devoid of any "factors which are extraneous to the pricing system," *id.*, would create. A well-functioning commodities market is predictable: as the delivery date for a particular futures contract draws near, the cash price for a commodity and the futures price will begin to converge on a single price. *See id.* ("As the delivery time draws near, not only do the cash and futures prices converge, but the markets converge by virtue of the delivery mechanism."); *Cargill, Inc.*, 452 F.2d at 1157 ("If the futures market is functioning properly, at the close of trading in the future, the price of the future will correspond closely to the price of the cash wheat . . . .")

Section 9(a)(2)'s requirement that there be an "artificial price" is what makes Count II so transparently flawed. The December 2011 wheat futures market functioned as it is supposed to: as delivery drew near, prices converged. Although the CFTC has provided sparse pricing data, the Complaint shows—even after drawing all reasonable inferences in the CFTC's favor—that cash and futures prices began to come together at the time of delivery. *See* ¶ 40. *See also* note 8

supra. Actions that are alleged to have made the market do what was expected of it cannot, under any reasonable interpretation, result in prices that are "artificial." Rather, prices produced by a properly-functioning market are consistent with the opposite of an artificial price—that is, a price consistent with the law of supply and demand. *See Indiana Farm Bureau*, 1982 WL 30249 at *4 n.2 ("When the aggregate forces of supply and demand bearing on a particular market are all legitimate, it follows that the price will not be artificial.") There is, therefore, no legal basis to claim that the price that existed in either the cash or futures market for wheat was artificial.

However, even if that were not the case, the CFTC has not alleged facts, such as historical pricing data, from which the Court could infer that prices in December 2011 were "artificial." *See Cargill*, 452 F.2d at 1167-68 (relying on historical pricing data to determine whether a price was "artificial"). While the CFTC alleges minimal pricing data for mid-to-late 2011 (¶¶ 24, 40), these data do nothing to indicate whether these prices were historically aberrational—for example, by alleging prices for the same time periods in years prior. *See Cargill*, 452 F.2d at 1167. Thus, the CFTC fails to state a claim that the December 2011 prices for wheat and wheat futures were "artificial."[16]

B. The CFTC has failed to state a claim for attempted price manipulation.

To state a claim for "attempted manipulation" under § 9(a)(2), the CFTC must allege (1) "intent to affect the market prices"; and (2) "some overt act in furtherance of that intent." *In re Hohenberg Bros. Co.*, CFTC No. 75-4, 1977 WL 13562, at *7 (Feb. 18, 1977). The "intent requirement," however, "is the same for a manipulation and an attempted manipulation." *Indiana Farm Bureau*, 1982 WL 30249, at *4. Thus, an allegation of "attempted manipulation" requires an allegation of an act "which *was intended to effect an artificial price*." *Id.* (internal

[16] In failing to state a claim that an "artificial price" existed, the CFTC necessarily also fails to state a claim that Kraft "caused" an "artificial price," as § 9(a)(2) requires.

quotation marks omitted) (emphasis added). Because, as discussed above, the CFTC has failed to allege that Kraft had the specific intent to create an "artificial price," the CFTC has necessarily failed to state a claim for attempted manipulation.

CONCLUSION

For the reasons stated above, the Court should dismiss Counts I and II of Complaint with prejudice.

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Respectfully submitted:

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STATUTORY AND REGULATORY APPENDIX

Commodities Exchange Act § 6(c)(1)	Securities Exchange Act § 10(b)
(1) Prohibition against manipulation It shall be unlawful for any person, directly or indirectly, to use or employ, or attempt to use or employ, in connection with any swap, or a contract of sale of any commodity in interstate commerce, or for future delivery on or subject to the rules of any registered entity, any manipulative or deceptive device or contrivance, in contravention of such rules and regulations as the Commission shall promulgate by not later than 1 year after July 21, 2010, provided no rule or regulation promulgated by the Commission shall require any person to disclose to another person nonpublic information that may be material to the market price, rate, or level of the commodity transaction, except as necessary to make any statement made to the other person in or in connection with the transaction not misleading in any material respect. **(A) Special Provision For Manipulation By False Reporting** Unlawful manipulation for purposes of this paragraph shall include, but not be limited to, delivering, or causing to be delivered for transmission through the mails or interstate commerce, by any means of communication whatsoever, a false or misleading or inaccurate report concerning crop or market information or conditions that affect or tend to affect the price of any commodity in interstate commerce, knowing, or acting in reckless disregard of the fact that such report is false, misleading or inaccurate. **(B) Effect on other law** Nothing in this paragraph shall affect, or be construed to affect, the applicability of section 13(a)(2) of this title. **(C) Good faith mistakes** Mistakenly transmitting, in good faith, false or misleading or inaccurate information to a price reporting service would not be sufficient to violate paragraph (1)(A).	It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange— * * * **(b)** To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, or any securities-based swap agreement any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

CFTC Rule 180	SEC Rule 10b-5
Rule 180.1 **Prohibition on the employment, or attempted employment, of manipulative and deceptive devices.**	**Employment of manipulative and deceptive devices.**
(a) It shall be unlawful for any person, directly or indirectly, in connection with any swap, or contract of sale of any commodity in interstate commerce, or contract for future delivery on or subject to the rules of any registered entity, to intentionally or recklessly:	It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
(1) Use or employ, or attempt to use or employ, any manipulative device, scheme, or artifice to defraud;	(a) To employ any device, scheme, or artifice to defraud,
(2) Make, or attempt to make, any untrue or misleading statement of a material fact or to omit to state a material fact necessary in order to make the statements made not untrue or misleading;	(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
(3) Engage, or attempt to engage, in any act, practice, or course of business, which operates or would operate as a fraud or deceit upon any person; or,	(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,
(4) Deliver or cause to be delivered, or attempt to deliver or cause to be delivered, for transmission through the mails or interstate commerce, by any means of communication whatsoever, a false or misleading or inaccurate report concerning crop or market information or conditions that affect or tend to affect the price of any commodity in interstate commerce, knowing, or acting in reckless disregard of the fact that such report is false, misleading or inaccurate. Notwithstanding the foregoing, no violation of this subsection shall exist where the person mistakenly transmits, in good faith, false or misleading or inaccurate information to a price reporting service.	in connection with the purchase or sale of any security.
(b) Nothing in this section shall be construed to require any person to disclose to another person nonpublic information that may be material to the market price, rate, or level of the commodity transaction, except as necessary to make any statement made to the other person in or in connection with the transaction not misleading in	

CFTC Rule 180	SEC Rule 10b-5
any material respect. (c) Nothing in this section shall affect, or be construed to affect, the applicability of Commodity Exchange Act section 9(a)(2). **Rule 180.2** **Prohibition on price manipulation.** It shall be unlawful for any person, directly or indirectly, to manipulate or attempt to manipulate the price of any swap, or of any commodity in interstate commerce, or for future delivery on or subject to the rules of any registered entity.	